STATE OF MICHIGAN

IN THE SUPREME COURT

APPEAL FROM THE MICHIGAN COURT OF APPEALS
Judges Patrick M. Meter, Michael J. Talbot and Stephen L. Borrello

CONSUMERS ENERGY COMPANY,

Appellant,

vs

MICHIGAN PUBLIC SERVICE COMMISSION,
Appellee.
/

Supreme Court No. 125955

Court of Appeals No. 237874

MPSC Case No. U-12134

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BRIEF ON APPEAL - APPELLANT CONSUMERS ENERGY COMPANY

ORAL ARGUMENT REQUESTED

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STATEMENT OF BASIS OF JURISDICTION

Appellant Consumers Energy Company ("Consumers Energy") applied for leave to appeal from the decision of the Michigan Court of Appeals in Detroit Edison v Public Service Commission No. 1, 261 Mich App 1; 680 NW2d 512 (2004), lv gtd ___ Mich ___; 688 NW 2d 510 (2004). By order dated November 5, 2004, the Supreme Court granted the application. Appellants Appendix, pp. 243a-244a. The Court limited the issues as follows:

> "On order of the Court, the application for leave to appeal the March 2, 2004 judgment of the Court of Appeals is considered, and it is GRANTED. The parties are directed solely to brief whether the December 2000 and October 2001 orders of the Michigan Public Service Commission are unlawful because they were not promulgated in conformity with the rulemaking provisions of the Administrative Procedures Act, MCL 24.201 et seq."

This Court has jurisdiction to review this case by appeal. MCR 7.301(A)(2); MCR 7.302(G).

STATEMENT OF QUESTION PRESENTED

A. DID THE MICHIGAN PUBLIC SERVICE COMMISSION VIOLATE THE MICHIGAN ADMINISTRATIVE PROCEDURES ACT ("MAPA") WHEN IT ADOPTED RULES HAVING GENERAL APPLICABILITY TO THE ELECTRIC UTILITY INDUSTRY WITHOUT FOLLOWING THE RULEMAKING PROVISIONS OF THE MICHIGAN ADMINISTRATIVE PROCEDURES ACT?

THE COURT OF APPEALS SAYS "NO."

CONSUMERS ENERGY SAYS "YES."

STATEMENT OF FACTS

Consumers Energy Company ("Consumers Energy") is a combination gas and electric public utility. Beginning in 1997, the Michigan Public Service Commission ("MPSC" or "the Commission") issued a series of orders establishing the rates, terms and conditions for implementing electric retail open access programs for Consumers Energy Company ("Consumers Energy") and The Detroit Edison Company ("Detroit Edison"). Retail open access allows retail customers to purchase electric power from suppliers other than the local distribution utility, and has sometimes been referred to as "retail wheeling." In connection with what were at that time retail open access programs voluntarily initiated by Consumers Energy and Detroit Edison, codes of conduct were implemented for both companies.[1] These codes of conduct were designed to ensure that sellers of electricity that are affiliated with the utilities did not receive any unfair advantage as a result of that affiliation.

On September 14, 1999, the Commission initiated a proceeding docketed as MPSC Case Nos. U-11290 and U-12134 "for the purpose of determining what modifications, if any, should be made to the existing codes of conduct" for Consumers Energy and Detroit Edison. See September 14, 1999 Order and Notice of Hearing, Case Nos. U-11290 and U-12134. Appellants' Appendix, p. 47a.

On June 5, 2000, prior to the issuance of a final order in Case Nos. U-11290/U-12134, 2000 PA 141, the "Customer Choice and Electricity Reliability Act" ("PA 141"), MCL 460.10 et seq, became effective. The enactment of PA 141 is a result, at least in part, of the Michigan Supreme Court decision in Consumers Power Co v PSC, 460 Mich 148; 596 NW 2d 126 (1999), in which the Court found that the MPSC lacked the

[1] The electric code of conduct for Consumers Energy was adopted in an order issued March 8, 1999 in MPSC Case No. U-11290, et al, reported at 191 PUR4th 523 (1999).

statutory authority to order retail open access. The passage of PA 141 in 2000 supplied the MPSC with that missing authority, and authorizes the Commission to direct the implementation of retail open access programs for jurisdictional utilities.

PA 141 is directed at putting in place an industry structure designed to encourage the development of a competitive retail market for the supply of electricity in Michigan. One of the apparent concerns of the legislature was that electric utilities would form affiliates or divisions to act as "alternative electric suppliers,"[2] and act in a manner that would harm the development of such a competitive retail electricity supply market. In that context, subsection 10a(4) of PA 141 (MCL 460.10a(4)) directs the Commission to adopt a code of conduct that will govern the relationship between electric utilities and their affiliated alternative electric suppliers. As originally enacted,[3] subsection 10a(4) provided as follows:

> "Within 180 days after the effective date of the amendatory act that added this section, the commission shall establish a code of conduct that shall apply to all electric utilities. The code of conduct shall include, but is not limited to, measures to prevent cross-subsidization, information sharing, and preferential treatment, between a utility's regulated and unregulated services, whether those services are provided by the utility or the utility's affiliated entities. The code of conduct established under this subsection shall also be applicable to electric utilities and alternative electric suppliers consistent with section 10, this section, and sections 10b through 10bb." MCL 460.10a(4).

Following the passage of PA 141, the Commission did not initiate rulemaking proceedings pursuant to the Michigan Administrative Procedures Act. Instead, the

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[2] "Alternative electric supplier" is the term used in PA 141 to describe the new entities licensed to make sales of electricity to retail customers pursuant to the retail open access program. MCL 460.10g(a).

[3] In 2004, subsection 10a(4) was amended by 2004 PA 88. As amended, the first sentence now reads "No later than December 2, 2000, the Commission shall establish a code of conduct that shall apply to all electric utilities." Emphasis added. In addition, the reference to "sections 10b through 10bb" was amended and now reads "sections 10b through 10cc." Emphasis added.

Commission issued an order on June 19, 2000 that provided for additional hearings in Case No. U-12134. Appellants Appendix, p. 51a. On December 4, 2000, the Commission issued an order that adopted a new code of conduct. See December 4, 2000 Opinion and Order, Case No. U-12134; 205 PUR4th 508; Appellants Appendix, p. 56a. Numerous rehearing petitions were filed by various parties, including Consumers Energy, and the Commission issued an Order on Rehearing on October 29, 2001, 213 PUR4th 252, that reaffirmed the December 4, 2000 code, with some minor revisions. Appellants' Appendix, p. 89a. The code attached to the October 29, 2001 Order on Rehearing is the code currently in effect and that is challenged in this appeal. Appellants Appendix, p. 108a.

The basic goal of the code adopted by the Commission is to separate the electric utility business conducted by electric utilities from other non-utility, unregulated businesses that are conducted by the utility and its affiliates and divisions. The goal of separation is seen most starkly in Section II A of the code, which states that an electric utility "shall not offer unregulated services or products except through one or more affiliates or through other entities within the corporate structure, such as divisions." Read literally, this section purports to forbid electric utilities from offering any unregulated service or product, unless it creates a separate business organization to do so.

Section II D provides a further elaboration of the intent of the code. This section says that an electric utility or alternative electric supplier "shall not share facilities, equipment, or operating employees" with "affiliates or other entities within its corporate structure." Read literally, this section apparently would forbid an electric utility from allowing any of its facilities, equipment or operating employees (e.g., buildings, trucks, tools, office equipment, billing systems, employees, etc) to be used in connection with the offering of any unregulated service or product. Thus, under this interpretation, achieving compliance

with the code would require the creation of a completely separate business entity, with duplicative facilities, equipment and operating employees, to conduct an unregulated business. That is, for example, two buildings would be required instead of one, two copiers would be required instead of one, and two employee staffs would be required instead of one. Interpreted in this manner, the code would destroy all efficiencies and economies of scale realized through the use of shared facilities, equipment and operating employees. A more realistic alternative to that of achieving compliance with the code through the creation of a separate business entity would be to simply terminate the offering of unregulated services and products. Termination of these businesses, however, would have a significantly adverse impact on Consumers Energy and its utility customers, since it would result in the loss of substantial revenues, the vast majority of which are used to reduce the cost of utility service, and thereby reduce utility rates. Termination would also eliminate services that many customers voluntarily choose to purchase, and that are valued by customers.

Throughout the course of the proceedings before the MPSC, Consumers Energy believed that the purpose of the proceedings was to develop a code of conduct that would be applicable only to electric retail open access activities. Such a code would apply to the relationship between Consumers Energy and any affiliated alternative electric suppliers that might be formed to participate in the retail open access market. This understanding was consistent with the MPSC Staff's principal policy witness, who testified that any code adopted in the proceeding "should only apply to the Retail Open Access program participants, Detroit Edison's 90 MW Experiment program and Consumers Energy's Direct Access

program."[4] Testimony of William J. Celio, 11 TR 792, August 22, 2000. Appellants' Appendix, p. 55a.

In the December 4, 2000 and October 29, 2001 orders, however, the Commission indicated its intent to apply the code of conduct beyond retail open access activities, to all non-utility businesses in which an electric utility might be involved. This decision was a major expansion of the scope of the previously effective code of conduct, which was applicable only to retail open access activities, and was made notwithstanding the recommendation of the MPSC Staff witness who proposed the code. Under these circumstances, the procedural protections afforded by the Administrative Procedures Act were even more important.

The provisions of the code are not mere guidelines, or general statements of policy. In connection with violations of the code, the Commission has claimed the right to impose substantial penalties, to issue cease and desist orders, to order refunds, and to order "any other remedies that would make whole a person harmed," including an award of attorneys fees. See Section VII(D) of the code of conduct which states that the penalties for

[4] The Detroit Edison "90 MW Experiment" and the Consumers Energy "Direct Access program" were predecessors of the full-fledged retail open access program

code violations shall be as provided in MCL 460.10c.[5] Appellants Appendix, p. 113a. To avoid such penalties, Consumers Energy must bring itself into compliance with the code, to the extent it can determine how to do so.

On November 20, 2001, Consumers Energy filed with the Court of Appeals a claim of appeal of the Commission's U-12134 orders. This appeal was subsequently consolidated with similar appeals filed by Detroit Edison (COA #237873) and the Michigan Electric Cooperative Association (COA #237872). On March 2, 2004, the Court of Appeals issued an opinion affirming the Commission's order in all respects. Detroit Edison v Public Service Commission No. 1, 261 Mich App 1; 680 NW2d 512 (2004), lv gtd ___ Mich ___;

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[5] The relevant portion of MCL 460.10c provides as follows:

> "Sec. 10c. (1) Except for a violation under section 10a(3) and as otherwise provided under this section, upon a complaint or on the commission's own motion, if the commission finds, after notice and hearing, that an electric utility or an alternative electric supplier has not complied with a provision or order issued under sections 10 through 10bb, the commission shall order such remedies and penalties as necessary to make whole a customer or other person who has suffered damages as a result of the violation, including, but not limited to, 1 or more of the following:
>
> "(a) Order the electric utility or alternative electric supplier to pay a fine for the first offense of not less than $1,000.00 or more than $20,000.00. For a second offense, the commission shall order the person to pay a fine of not less than $2,000.00 or more than $40,000.00. For a third and any subsequent offense, the commission shall order the person to pay a fine of not less than $5,000.00 or more than $50,000.00.
>
> "(b) Order a refund to the customer of any excess charges.
>
> "(c) Order any other remedies that would make whole a person harmed, including, but not limited to, payment of reasonable attorney fees.
>
> "(d) Revoke the license of the alternative electric supplier if the commission finds a pattern of violations.
>
> "(e) Issue cease and desist orders." MCL 460.10c.

688 NW 2d 510 (2004). Applications for leave to appeal were filed by Consumers Energy, Detroit Edison and the Michigan Electric Cooperative Association. On November 5, 2004, the Supreme Court granted the applications, and directed the parties to brief only "whether the December 2000 and October 2001 orders of the Michigan Public Service Commission are unlawful because they were not promulgated in conformity with the rulemaking provisions of the Administrative Procedures Act, MCL 24.201 et seq."[6]

ARGUMENT

The Code of Conduct Constitutes A Rule Which Was Not Promulgated in Accordance with the Rulemaking Procedures Prescribed in the Administrative Procedures Act

A. Introduction

Consumers Energy argued before the Court of Appeals that the Commission erred by failing to adopt the code of conduct in a manner consistent with the rulemaking procedures required by the Michigan Administrative Procedures Act of 1969 ("APA"). MCL 24.201 et seq. The Court of Appeals rejected that contention, holding that "the code of conduct is not a rule because it was implemented via orders entered in a contested case." Detroit Edison v Public Service Commission No. 1, 261 Mich App at 11. This holding is a

[6] In a separate order issued October 3, 2002, the Commission denied waiver requests that had been submitted by Consumers Energy pursuant to Section VI of the code of conduct. Appellants Appendix, p. 141a. In that order, the Commission declined to grant a hearing, relied upon non-record written materials from unnamed sources in formulating its decision, and refused to allow Consumers Energy to either review the non-record material, or to present evidence countering the non-record information. This order was appealed to the Court of Appeals, which, in an unpublished opinion issued August 17, 2004, declined to address the issues raised by Consumers Energy. Court of Appeals No. 244429. Consumers Energy filed an application for leave to appeal with the Michigan Supreme Court, which is pending in Supreme Court No. 127473. While the Commission contends in the instant appeal that it conducted the proceeding as a "contested case", in the appeal pending in Supreme Court No. 127473, the Commission refused Consumers Energy the most rudimentary procedural protections required under the contested case provisions of the Administrative Procedures Act.

violation of the Administrative Procedures Act, and also directly conflicts with a recent published decision of the Court of Appeals. In re Public Service Commission Guidelines for Transactions Between Affiliates, 252 Mich App 254; 652 NW2d 1 (2002). The guidance of the Supreme Court is needed to remove this conflict, MCR 7.302(B)(5), and to clarify whether an administrative agency in Michigan is required to follow the rulemaking procedures set forth in the Administrative Procedures Act when it wishes to adopt a "rule," or whether it can evade those procedures simply by initiating a proceeding that it labels a "contested case."

B. The Court Of Appeals Failed To Apply The Appropriate Standard Of Review

In its opinion, the Court of Appeals applied a highly deferential standard of review to the Commission's decision. That is explicitly evidenced by the standard that it stated it was following, and implicitly evidenced by the analysis set forth in the opinion. The highly deferential standard of review followed by the Court of Appeals in appeals of decisions from the Public Service Commission and the extraordinary burden that standard places on appellants effectively immunizes the Commission from judicial review, in violation of Section 26(8) of the Railroad Act, MCL 462.26(8), the Administrative Procedures Act, MCL 24.201 et seq, the Michigan Constitution, and common sense.

Section 26 of the Railroad Act, MCL 462.26(8), sets forth the statutorily-prescribed standard of review applicable to decisions of the MPSC:

> "(8) In all appeals under this section the burden of proof shall be upon the appellant to show by clear and satisfactory evidence that the order of the commission complained of is unlawful or unreasonable." Emphasis added.

The Court of Appeals stated the standard of review it would apply in this case as follows:

> "The standard of review for PSC orders is narrow and well-defined. MCL 462.25 states that all rates, fares, charges, classification and joint rates, regulations, practices and services prescribed by the PSC are presumed, prima facie, to be lawful and reasonable. [citation omitted] A party aggrieved by an order of the PSC has the burden of proving by clear and convincing evidence that the order is unlawful or unreasonable. MCL 462.26(8). To establish that a PSC order is unlawful, the appellant must show that the PSC failed to follow a mandatory statute or abused its discretion in the exercise of its judgment. [citation omitted] An order is unreasonable if it is not supported by the evidence. [citation omitted]"
>
> "We give due deference to the PSC's administrative expertise and will not substitute our judgment for that of the PSC. [citation omitted] A reviewing court must give great weight to any reasonable construction of a regulatory scheme that the PSC is empowered to administer, [citation omitted], but the court may not abandon its responsibility to interpret statutory language and legislative intent. [citation omitted] A reviewing court does not afford the same measure of deference to an agency's initial interpretation of new legislation as it does to a longstanding interpretation. [citation omitted] Whether the PSC exceeded the scope of its authority is a question of law that we review de novo. [citation omitted]. Appendix A, p. 5. Emphasis added.

The standard of review stated by the Court of Appeals is internally inconsistent, and is unlawful and defective on its face.[7] In addition, the manner in which the Court of Appeals applied this standard in this appeal compounded the legal error. The legal errors committed in the Court of Appeals opinion with respect to the standard of review are summarized below:

[7] Even relatively small matters, such as expressing the statutory standard as "clear and convincing evidence" rather than the "clear and satisfactory evidence" language actually stated in the statute, demonstrate the perhaps unintentional manner in which the Court of Appeals has constructed hurdles to the objective review of Commission decisions. There is obviously a difference between a "convincing evidence" standard and a "satisfactory evidence" standard. Whether an accurate statement of the correct statutory standard would have made any difference, (or even whether the difference merely represents an inadvertent mistake), is impossible to know, but it illustrates the extremely deferential mind-set the Court of Appeals brought to its review of the Commission's order.

1. The Court Of Appeals Failed To Review The Issues Of Law De Novo

The issue raised by Consumers Energy in this appeal is one of law. It concerns the interpretation of an existing statute, the Administrative Procedures Act. This Court has previously ruled that "[q]uestions of statutory interpretation are questions of law, which will be reviewed de novo." In re MCI Telecommunications Complaint, 460 Mich 396, 413; 596 NW2d 164 (1999). See also Cardinal Mooney High School v Michigan High School Athletic Association, 437 Mich 75, 80; 467 NW2d 21 (1991). Black's Law Dictionary defines an "appeal de novo" as follows: "[a]n appeal in which the appellate court uses the trial courts record but reviews the evidence and law without deference to the trial court's findings." Black's Law Dictionary, Seventh Edition.[8] Emphasis added. Because the issues raised before the Court of Appeals are issues of law,[9] they were required to be reviewed de novo, without giving any deference to the MPSC's decision. Although the Court of Appeals agreed that it was obligated to review these issues de novo, it also claimed it was required to give "due deference" to the Commission's administrative expertise, and "great weight" to the Commission's construction of the relevant statute. Giving such deference and weight is wholly inconsistent with the Supreme Court's direction that the Court of Appeals review these matters de novo.

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[8] See also DCR v Silver Dollar Cafe, 441 Mich 110, 115-116, 490 NW2d 337 (1992), where the Supreme Court provided a comparable interpretation of the term "de novo" as used in the Michigan Constitution.

[9] Consumers Energy is not contending in this appeal that appellate review of issues of fact is necessarily de novo.

2. The Court Of Appeals Misconstrued MCL 462.25 And Applied An Incorrect Standard Of Appellate Review When It Stated That The Commission's Orders Were "Prima Facie Lawful And Reasonable"

The Court of Appeals stated that the order of the Commission was presumed, prima facie, to be lawful and reasonable, citing Section 25 of the Railroad Act, 1909 PA 300, MCL 462.25 in support of this standard. The Court of Appeals misunderstood and misapplied this statute. MCL 462.25 states, in relevant part, as follows:

> "Sec. 25. All rates, fares, charges, classification and joint rates fixed by the commission and all regulations, practices and services prescribed by the commission shall be in force and shall be prima facie, lawful and reasonable until finally found otherwise in an action brought for the purpose pursuant to the provisions of section 26 of this act, or until changed or modified by the commission as provided for in section 24 of this act." Emphasis added.

This section clearly does not establish a standard applicable to the judicial review of Commission orders. It is merely stating that Commission orders are considered in force and effect until the Commission changes them, or the Courts reverse them. It does not impose any requirement on the courts that they defer to Commission orders, or that they must assign great weight to the legal analysis set forth in a Commission order. The only reference to a standard for judicial review that is contained in the Railroad Act is that stated in Section 26; i.e., that "the order of the commission complained of is unlawful or unreasonable." MCL 462.26(8).

3. No Deference Is Appropriate Where The Issue Concerns The Commission's Statutory Authority Under the Administrative Procedures Act

The Court of Appeal's discussion quoted above displays some considerable confusion with respect to the appropriate legal standard to be applied to the statutory authority questions raised in this appeal, and with respect to the "deference" to be accorded the

Commission's decision. As limited by the order granting the application for leave to appeal, Consumers Energy's appeal raises an issue that requires an interpretation of the extent of the Commission's authority under the Administrative Procedures Act.

The resolution of this issue requires a determination of whether the Commission can evade the rulemaking requirements of the Administrative Procedures Act simply by conducting a proceeding it labels a "contested case." The Court of Appeals states that it must give "due deference to the PSC's administrative expertise" and "great weight to any reasonable construction of a regulatory scheme that the PSC is empowered to administer." In the context of judicial review of MPSC decisions, the concept of deference is more applicable to factual issues, where the courts routinely defer to the Commission's factual and evidentiary findings, based upon the Commission's expertise with respect to such matters. With respect to the statutory interpretation issue in this case, this statement of the standard of review is simply wrong.

The Administrative Procedures Act was intended to create a structure that prescribes how administrative agencies are to adopt "regulations, statements, standards, policies, rulings, or instructions of general applicability." Thus, its very purpose is to impose a framework that must be followed by an agency in adopting such rules. With respect to such a statutory interpretation issue (especially those concerning the scope of the Commission's powers), it simply makes no sense for the Courts to defer to the Commission's legal judgments. As the Court of Appeals ruled in Ram Broadcasting of Mich v MPSC, 113 Mich App 79; 317 NW2d 295 (1982),

> "The more appropriate rule of statutory construction is that the extent of the authority of public agencies is measured by the statute from which they derived their authority and not by their own acts and assumption of authority. Mason County Civic Research Council v Mason County, 343 Mich 313;

> 72 NW2d 292 (1955). Moreover, this is not an area in which the commission's technical expertise suggests that the Legislature would be likely to acquiesce in the MPSC's interpretation. It is a pure question of law involving statutory interpretation, one in which the MPSC's technical expertise plays a small role." 113 Mich App at 91-92. Emphasis added.

The Administrative Procedures Act is not an act that the Commission has been directed to administer; rather it exists to impose procedural restrictions on the Commission. The Commission's technical expertise in matters involving utilities has no bearing on the interpretation of statutes generally, and this is especially so with respect to a procedural act such as the APA. There is no legal justification for deferring to the Commission's interpretation of the APA.

4. Conclusion

The Court of Appeals failed to review the Commission's decision de novo, improperly relied upon MCL 462.25, and gave deference to the Commission's interpretation of its statutory authority under the Administrative Procedures Act. The effect of the standard of review that was applied by the Court of Appeals is that the MPSC is effectively immunized from appellate review, in violation of MCL 462.26(8), Sections 85 and 101[10] of the Administrative Procedures Act, and the Michigan Constitution.[11]

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[10] MCL 24.301 states that a final decision or order of an administrative agency "is subject to direct review by the courts as provided by law."

[11] Article 6, Section 28 of the Michigan Constitution of 1963 states as follows:

> "Sec. 28. All final decisions, findings, rulings and orders of any administrative officer or agency existing under the constitution or by law, which are judicial or quasi-judicial and affect private rights or licenses, shall be subject to direct review by the courts as provided by law. This review shall include, as a minimum, the determination whether such final decisions, findings, rulings and orders are authorized by law; and, in cases in which a hearing is required, whether the same are supported by competent, material and substantial evidence on the whole record." Emphasis added.

C. The Commission's Failure To Comply With The Administrative Procedures Act

1. The Legislative Preference For Rulemaking

Section 7 of the Michigan Administrative Procedures Act ("APA") defines a "rule" as follows:

> "'Rule' means an agency regulation, statement, standard, policy, ruling, or instruction of general applicability that implements or applies law enforced or administered by the agency, or that prescribes the organization, procedure, or practice of the agency, including the amendment, suspension, or rescission of the law enforced or administered by the agency." MCL 24.207.

The code of conduct adopted by the Commission clearly sets forth "standards" of "general applicability" that purport to implement "law enforced or administered" by the MPSC. The code prescribes a lengthy list of prohibited or regulated actions/activities, and applies to all electric utilities subject to the Commission's jurisdiction. Further, the code is intended to have general and prospective effect, as opposed to being an application of existing law or regulation to a specific set of facts. Finally, the code adopts stringent penalties for violations of its terms. The code seems to be a perfect example of what a reasonable person would regard as "rules."

In Michigan, the preferred method of agency policy making is by the promulgation of rules. See Detroit Base Coalition for Human Rights of Handicapped v Department of Social Services, 431 Mich 172, 185; 428 NW2d 335 (1988). In Detroit Base Coalition, the Court explained and emphasized this legislative preference for rulemaking:

> "Since the adoption of a rule by an agency has the force and effect of law and may have serious consequences of law for many people, the Legislature has proscribed an elaborate procedure for rule promulgation. As set forth in the APA, [citations omitted], that process requires public hearings, public

> participation, notice, approval by the joint committee on administrative rules, and preparation of statements, with intervals between each process."
>
> "This action was taken because, in recent years, legislative bodies have delegated to administrative agencies increasing authority to make public policy and consequently, have recognized a need to 'ensure that none of the essential functions of the legislative process are lost in the course of the performance by agencies of many law-making functions once performed by our legislatures. [citations omitted] Thus, the question whether the policy may be adopted without compliance with the APA is more than a question of notice and hearing requirements. It is a question of the allocation of decision-making authority."[12] 431 Mich at 177-178.

The Michigan Supreme Court has also held that, in determining whether a particular agency action constitutes a rule, it "must review the actual action undertaken by the directive, to see whether the policy being implemented has the effect of being a rule." American Federation of State, County and Municipal Employees (AFSCME) v Department of Mental Health, 452 Mich 1; 550 NW2d 190 (1996). In AFSCME, the Supreme Court further held that, "an agency may not circumvent APA procedural requirements by adopting a guideline in lieu of a rule," and "in order to reflect the APA's preference for policy determinations pursuant to rules, the definition of 'rule' is to be broadly construed, while the exceptions are to be narrowly construed." 452 Mich at 10.

The exceptions to the definition of a "rule" that were discussed by the Court of Appeals were MCL 24.207(f), "a determination, decision or order in a contested case," and MCL 24.207(j), "a decision by an agency to exercise or not to exercise a permissive statutory power." Rather than construe these exceptions "narrowly," as required by the Supreme Court,

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[12] The procedure for adoption of a rule that was in effect when Detroit Base Coalition was decided was modified by the passage of 1999 PA 262. The revised rulemaking procedure, however, is also designed to provide multiple layers of review and safeguards, and equally concerns the "allocation of decision making authority."

the Court of Appeals decision construes them so broadly that they effectively nullify the APA's rulemaking procedures, and thereby allow the Commission to evade that rulemaking process. These are discussed below.

2. The "Contested Case" Exception And The Conflict With A Prior Published Decision of the Court of Appeals

One of the more glaring defects in the Court of Appeal's opinion is the complete failure to address the impact of the recent decision in In re Public Service Commission Guidelines for Transactions Between Affiliates, supra. In that case, the Court of Appeals affirmed the longstanding statutory requirement that the MPSC must follow the rulemaking procedures mandated by the Michigan Administrative Procedures Act of 1969 ("APA"), MCL 24.201 *et seq.* when adopting "rules of general applicability." The facts surrounding the adoption of the code of conduct in the instant case are directly comparable to those In re Public Service Commission Guidelines for Transactions Between Affiliates. In that case, the Commission had adopted "guidelines" governing transactions between utilities and their affiliates. The Commission had done so in what it called a "contested case," and argued that its action was therefore exempt from the definition of a "rule" under MCL 24.207(f). Since the "guidelines" were therefore not "rules," the Commission reasoned that there was no requirement that it follow the rulemaking procedures.

In In re Public Service Commission Guidelines for Transactions Between Affiliates, the Court of Appeals rejected the Commission's contention on several grounds. First, the Court noted that the label an agency assigns to an action is not dispositive; instead the court must examine the actual action undertaken by the directive to determine whether the policy had the effect of a rule. See In re Public Service Commission Guidelines for Transactions Between Affiliates, supra at 265; citing AFSCME v Department of Mental

Health, supra. The Court noted that, under the APA, a "contested case" is defined as "a proceeding, including rate-making, price-fixing, and licensing, in which a determination of legal rights, duties, or privileges of a named party is required by law to be made by an agency after an opportunity for an evidentiary hearing." MCL 24.203(3). The Court found that, although the Commission had labeled the case in which the affiliate guidelines were adopted a "contested case," it "only tangentially involved ratemaking," and thus did not fit within that category of contested cases. 252 Mich App at 265-266. Further, the Court noted that "[t]he typical contested case proceeding involves an individual named party and a disputed set of facts—e.g., a license denial, a denial of benefits, or a statutory violation—from which results an agency order that adjudicates the specific factual dispute and operates retroactively to bind the agency and the named party." Id, at 267. The Court found that this was far different from what the Commission had done in adopting the affiliate "guidelines," which were "regulatory standards that would have general and prospective application to all electric and natural gas

utilities subject to the PSC's jurisdiction, as well as the nonregulated affiliates and subsidiaries of those utilities." Id, at 267.[13]

The situation just described is virtually identical to what occurred in this code of conduct case. Again the Commission initiated a proceeding that it labeled a "contested case," notwithstanding the fact that it had essentially nothing to do with ratemaking and was

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[13] The distinction between the adjudication of a specific factual dispute in a contested case versus the establishment of a standard of general applicability via the rulemaking process is further illustrated in Northern Michigan Exploration Co v PSC, 153 Mich App 635; 396 NW2d 487 (1986) and American Way Life Insurance Co v Insurance Commissioner, 131 Mich App 1; 345 NW2d 634 (1983); lv den 419 Mich 937; 347 NW2d 32 (1984). In Northern Michigan Exploration Co v PSC, the Commission was requested to issue a "proration" order; i.e., an order allocating the total production of gas from a common reservoir among the various wells drilled into the reservoir. This case involved a dispute concerning an actual set of facts to which the Commission attempted to apply its existing rules and policies. It is important to note that there was a rule in effect that authorized the Commission to adopt various means for the issuance of proration orders. 1979 AC, R 460.865(4); See 153 Mich App at 647. The appellant argued, however, that the specific proration formula used by the Commission in that case (a 90-10 weighting of different factors) was a policy that should have been adopted as a rule. The Court in that case properly recognized the difference between a decision that applied an existing rule to a set of facts in a contested case setting, and the adoption of a "standard of general applicability" which must be adopted pursuant to the APA rulemaking process.

Similarly, American Way Life Insurance Co v Insurance Commissioner involved a dispute concerning the amount of the premium for a new type of credit insurance. Following a contested case proceeding, the Insurance Commissioner ordered the insurance company to reduce the premium. The insurance company argued that, since the case involved a new type of policy, the Commission should have established a premium of general applicability through the rulemaking process. Again, the Court properly rejected this position, explaining the difference between the adoption of a rule of general applicability via the rulemaking process and resolving the lawfulness of a specific premium for a specific company through a contested case. The Court stated:

> "The APA definition of a rule expressly excludes any 'order establishing or fixing rates', MCL 24.207(c); MSA 3.560(107)(c), and any 'determination, decision or order in a contested case', MCL 24.207(f); MSA 3.560(107)(f). The commissioner's decision to disapprove a particular insurer's premium following a hearing as provided in Section 15 of the Credit Insurance Act is not a ruling of general applicability and is not a rule within the meaning of the APA. The rate decision in a contested case is binding only upon the particular insurer or insurers involved." 131 Mich App at 7. Emphasis added.

not an adjudication of a specific factual dispute. Instead, the whole point of the code of conduct proceeding was to adopt "regulatory standards that would have general application to all electric . . . utilities subject to the PSC's jurisdiction, as well as the nonregulated affiliates and subsidiaries of those utilities." Yet, the Court of Appeals ruled exactly to the contrary of its own previous decision. Worse, it failed to even attempt to distinguish the prior published decision.[14]

The "contested case" exception in the APA was clearly designed to avoid contentions that licensing/ratemaking actions or agency adjudications of specific factual disputes were required to be addressed via the rulemaking process. It was clearly not intended to establish contested cases as an alternative means of adopting rules. Indeed, in In re Public Service Commission Guidelines for Transactions Between Affiliates, the Court was extremely critical of the Commission for effectively inventing a procedure for the adoption of rules:

> "Invoking the public interest and the need for policy that is responsive to a changing industry, the PSC eschewed the procedural mandates of the APA in favor of its own course of action. By choosing to implement 'guidelines' by order in a contested case against unnamed parties, yet with the force and effect of law, the PSC culled elements of rulemaking, adjudication, and general policy formulation, with little regard for the dictates of the APA. While we do not doubt the PSC's legitimate concerns of lack of access to the accounts and records of a utility's nonregulated affiliates and subsidiaries, and the potential for 'cross-subsidization of nonutility investments through utility rates,' [citation omitted], the process utilized by the PSC constituted a rather heavy-handed rebuke of

[14] MCR 7.215(J)(1) states as follows:

> "(1) *Precedential Effect of Published Decisions.* A panel of the Court of Appeals must follow the rule of law established by a prior published decision of the Court of Appeals issued on or after November 1, 1990, that has not been reversed or modified by the Supreme Court, or by a special panel of the Court of Appeals as provided in this rule."

established APA procedures, and accordingly, we are compelled to invalidate that process." 252 Mich App at 267-268.

In the instant case, the Commission again engaged in another "heavy-handed rebuke of established APA procedures," and again essentially manufactured a rulemaking procedure of its own creation. In order to clarify the law in this area, and to correct the error that occurred in this case, this Court's intervention is required.

3. The "Permissive Statutory Power" Exception

The Court of Appeals also cites MCL 24.207(j), which indicates that a decision by an administrative agency to exercise a "permissive statutory power" is exempt from the definition of a "rule" in the APA. Although the Court of Appeal's opinion is somewhat confusing on this issue, it does recognize that, while the decision to exercise a permissive statutory power may not constitute rulemaking, "its implementation of that authority is subject to the APA's rulemaking procedures," citing AFSCME v Department of Mental Health, supra. Detroit Edison v Public Service Commission No. 1, 261 Mich App at 12. This statement is consistent with the Court of Appeal's earlier interpretation of this provision in Spear v Michigan Rehabilitation Services, 202 Mich App 1; 507 NW2d 761 (1993). In that case, the state agency had adopted a "needs" test for determining eligibility for certain benefits. The Court held that the decision to adopt a needs test was the exercise of a permissive statutory power, since the agency was not required to do so. Once the decision to adopt such a test was made, however, the Court held that the "policies implementing that test are mandatory and, therefore, do not come within the exercise of discretionary statutory authority so as to remove the matter from the definition of a 'rule' under the Administrative Procedures Act." 202 Mich App at pp. 4-5. Thus, the specific needs test itself was a rule, and the agency was required to follow the APA rulemaking procedures in adopting the test.

This two-step distinction is helpful in examining the Commission's actions in the context of this appeal. In the instant case, the adoption of a code of conduct is not an example of "a decision by an agency to exercise or not to exercise a permissive statutory power" because Section 10a(4) of PA 141 requires the Commission to adopt a code. That is a mandatory, not permissive, requirement. As such, the exemption from rulemaking applicable to a decision to exercise or not exercise a permissive statutory power simply does not apply.[15] In any event, the implementation of that mandatory requirement through the adoption of the code of conduct clearly represents the adoption of standards of general applicability that should have been done via the APA rulemaking procedures.

4. The Legislatively-Mandated Rulemaking Process Provides Substantive Protections

Requiring the Commission to follow APA rulemaking procedures would not be a meaningless exercise. The "contested case" procedures allegedly followed by the Commission in the adoption of the code are not an adequate substitute for the legislatively-prescribed rulemaking process. If the APA rulemaking procedure had been followed by the Commission, it would have been required to prepare a Regulatory Impact Statement, which included the following information and analysis:

> "(a) A comparison of the proposed rule to parallel federal rules or standards set by a state or national licensing agency or accreditation association, if any exist.
>
> "(b) An identification of the behavior and frequency of behavior that the rule is designed to alter.

[15] This also distinguishes the instant case from Michigan Trucking Association v Public Service Commission, 225 Mich App 424; 571 NW2d 734 (1997); lv den 459 Mich 859; 583 NW2d 900 (1998). In that case, the controlling statute gave the Commission the discretion to proceed "by rule or order." The Court found that its decision to proceed by order was the exercise of a permissive statutory power. No similar option was provided by the legislature in MCL 460.10a(4). Thus, the Commission had no lawful alternative but to comply with the rulemaking provisions of the Administrative Procedures Act.

"(c) An identification of the harm resulting from the behavior that the rule is designed to alter and the likelihood that the harm will occur in the absence of the rule.

"(d) An estimate of the change in the frequency of the targeted behavior expected from the rule.

"(e) An identification of the businesses, groups or individuals who will be directly affected by, bear the cost of, or directly benefit from the rule.

"(f) An identification of any reasonable alternative to regulation pursuant to the proposed rule that would achieve the same or similar goals.

"(g) A discussion of the feasibility of establishing a regulatory program similar to that proposed in the rule that would operate through market-based mechanisms.

"(h) An estimate of the cost of rule imposition on the agency promulgating the rule.

"(i) An estimate of the actual statewide compliance costs of the proposed rule on individuals and other groups.

"(j) An estimate of the actual statewide compliance costs of the proposed rule on businesses and other groups.

* * *

"(t) An estimate of the primary and direct benefits of the rule.

"(u) An estimate of any cost reductions to businesses, individuals, groups of individuals, or governmental units as a result of the rule.

"(v) An estimate of any increase in revenues to state or local governmental units as a result of the rule.

"(w) An estimate of any secondary or indirect benefits of the rule.

"(x) An identification of the sources the agency relied upon in compiling the regulatory impact statement.

"(y) Any other information required by the office of regulatory reform." MCL 24.245(3)(a) through (j) and (t) through (y).

Consumers Energy submits that the consideration of such issues would have allowed for a more reasoned and thoughtful evaluation of the need for and construction of many of the provisions of the code of conduct. Indeed, that was undoubtedly the intent of the legislature in imposing such a requirement on agencies engaged in the adoption of generally applicable standards (i.e., rules). The Commission's failure to follow the APA rulemaking requirements resulted in a failure to consider the very factors the legislature deemed important in evaluating the adoption of rules such as the code of conduct.

The failure to comply with the rulemaking procedures was especially harmful given the Commission's decision to apply the code of conduct to non-utility businesses of Consumers Energy that produce revenues that are used to reduce utility rates. In an order issued October 3, 2002 (also docketed in MPSC Case No. U-12134; see Appellants Appendix, p. 141a), the Commission denied "waivers" from portions of the code of conduct with respect to heating and air conditioning services and appliance repair services. Despite Consumers Energy's urging, the Commission refused to even acknowledge the fact that these non-utility businesses produced over $10 million of net profits, all of which was applied toward reductions in gas utility rates. The above-quoted provisions of the Administrative Procedures Act (specifically MCL 24.245(e), (i) and (j)) would have required the Commission to take such impacts into consideration. By failing to follow the rulemaking requirements, the Commission effectively evaded the requirement that such factors be taken into consideration.

More broadly, the Commission's failure to follow the rulemaking provisions of the APA allowed it to evade its responsibility to evaluate the impacts of the code of conduct on competition. By imposing the detailed restrictions contained in the code of conduct, the

result is to inhibit, if not outright prohibit, the ability of an electric utility to participate in non-utility businesses. That is, the whole point of the code of conduct is to restrict and regulate competition. While Consumers Energy acknowledges that this is indeed the general purpose of the code of conduct, it seems obvious that restrictions on competition ought not be imposed without good reason. Compliance with the rulemaking requirements of the Administrative Procedures Act would have obligated the Commission to (i) identify the specific competitive behavior that the code is designed to alter (MCL 24.245(b)), (ii) identify the harm from that competitive behavior that the code is intended to alter and the likelihood that the harm will occur in the absence of the code (MCL 24.245(c)), (iii) identify the businesses, groups and individuals that will be affected by, and bear the costs of, the code (MCL 24.245(e)), and (iv) discuss the feasibility of establishing market-based mechanisms as an alternative to the code (MCL 24.245(g)). The Commission failed to consider any of these factors, and instead constructed a six page single-spaced document with numerous sections and subsections that purports to comprehensively regulate competition in markets for heretofore unregulated services that are nowhere mentioned in PA 141.

It must be emphasized that the Commission has insisted that the code applies not only to electric power markets, but also to any other non-utility, non-electricity markets in which utilities might participate. See October 29, 2001 Order on Rehearing; Appellants Appendix, pp. 100a-102a. This includes such activities as appliance repair services, heating and air conditioning services, water meter reading services, tree-trimming services, etc. Notwithstanding its insistence that the code apply to markets beyond those it has traditionally regulated, the Commission never actually evaluated the level of competition in any of these markets, the extent to which utilities participate in these markets, or the extent to which the participation by utilities increases or harms competition in these markets. Had the

Commission followed the rulemaking requirements of the Administrative Procedures Act, it would have been required to do so.

The standards adopted by the MPSC in the code of conduct represent extremely controversial and stringent restrictions on the ability of electric utilities to conduct lawful businesses and engage in lawful activities. Even if the Court believes that the MPSC has the statutory authority to impose such substantive restrictions, it should also recognize that the adopted standards contain numerous specific and detailed restrictions that are not expressly specified by PA 141. Under these circumstances, the Court should insist upon the application of the protections provided by the APA rulemaking process. Indeed, if the Commission can adopt the type of generally applicable rules contained in the code of conduct without adherence to APA rulemaking procedures, then those procedures are effectively rendered null and void. That surely was not the intent of the legislature.

Because the code of conduct was not adopted in compliance with the APA, it is of no legal force or effect. Spruyette v Walters, 753 F2d 498 (CA6, 1985). See also Goins v Jeep Eagle, Inc 449 Mich 1, 10; 534 NW2d 467 (1995) and Pharris v Secretary of State, 117 Mich App 202, 204-205; 323 NW2d 652 (1982). The Court should remand this matter to the Commission, and direct it to follow the APA rulemaking procedures in developing a code of conduct consistent with the provisions of MCL 460.10a(4).

REQUESTED RELIEF

WHEREFORE, Consumers Energy respectfully requests the Court to:

A. Find that the Court of Appeals erred in failing to rule that the Commission violated the Administrative Procedures Act in adopting the code of conduct;

B. Reverse the Court of Appeals March 2, 2004 decision and the MPSC's December 4, 2000 and October 29, 2001 orders consistent with the above finding;

C. Remand this matter to the MPSC with the direction that it follow the rulemaking procedures of the Administrative Procedures Act in establishing a code of conduct pursuant to MCL 460.10a(4).

Respectfully submitted,

CONSUMERS ENERGY COMPANY

Dated: January 3, 2005 By: 

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